

Socio-Economic Strategies to Counter Islamic Extremism in Iraq

by

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Introduction

The events of September 11 made it painfully clear that the political, social and economic problems of other countries have a direct impact on American national security. While the roots of terrorism are complex¹, it is safe to say that the United States was attacked by a terrorist organization that in large part has had great success in recruiting new members in nations which offer young men little political voice and limited economic opportunity.

In December 2002, US Secretary of State Colin Powell, speaking before an audience at the Heritage Foundation remarked on the emergence of Islamic extremist movements: "A shortage of economic opportunities is a ticket to despair. Combined with rigid political systems, it is a dangerous brew indeed."²

Alan Richards has also noted a common element in extremist movements³:

Radical movements have their greatest appeal when the dislocations of the transition to modernity are most acute. Only the slaughter of World War I and its chaotic aftermath allowed the Bolsheviks to seize power in Russia. It is inconceivable that Hitler would have come to power without the Treaty of Versailles and the Great Depression. Famine, governmental collapse and the horrors of the Japanese invasion set the stage for China and Chairman Mao Tse-tung. The siren song of fanatics becomes most seductive when economic, political, social, and cultural crises combine and when people feel that they have been repeatedly humiliated.

In the contemporary setting Richards finds "the utopian fanaticism of al-Qa'ida and other groups is nourished by the despair of huge numbers of young Middle Easterners, half of whom are younger than twenty."⁴ Clearly, the current environment in the Middle East leading to extremism is extremely complex, composed of economic,

¹ For a good overview of the issues see Paul R. Ehrlich and Jianguo Liu, "Some Roots of Terrorism," *Population and Environment* 24:2 (November 2002).

² Colin Powell, speech before the Heritage Foundation, Washington, DC, December 12, 2002.

³ Alan Richards, "Socioeconomic Roots of Middle East Radicalism," *Naval War College Review* 55:4 (Autumn 2002), p. 22.

⁴ *Ibid.*

social, political, and cultural dimensions.⁵ Additional complexity stems from the fact that the socio-economic forces driving radicalism are both internal and external. It is internal because of population growth, failed economic policies, local authoritarianism and cultural issues. It is external because wider forces of globalization play a critical role in stimulating the growth and spread of radicalism.

Much of the region's economic stagnation derives from its weak and distorted integration into the global economy. At the same time, the kinds of integration that have occurred—specifically international migration and the spread of global communications have themselves contributed to the spread of radicalism. Also, in large part, the failure of local regimes stems from a failure to manage and engage successfully in the wider process of globalization.⁶

In addition to socio-economic factors, a whole spectrum of motivations for joining Islamic Fundamentalist groups has been documented in the literature. Individuals may join extremist groups to achieve specific political objectives such as sovereignty over disputed territory. Emotional incentives may also play an important role. Members of extremist groups often report on the glamour of being members of such groups. Unknown, lower-class youth can become famous through their military actions, with thousands turning out for their funerals when they are martyred. However, "the single most common emotional feature among *jihadi* militants, regardless of their rank is their feeling that they have been humiliated and treated as "second class" by government authorities and others—even those *jihadis* from relatively rich countries and advantaged backgrounds.⁷

Given the myriad of factors enhancing the attractiveness of the extremist message to many in the Islamic world, few concrete generalizations can be made for the purpose of combating the pull of Islamic extremism. No doubt the relative strength of these factors noted above on the attractiveness of extremism will vary considerably from country to country. Numerous detailed country case studies⁸ will have to be analyzed before any meaningful generalizations can be made.

As a step in this direction, the sections below assess the situation in Iraq. Socio-economic factors do not get much attention in the vast literature on Iraq – they are a long run latent factor and it is difficult to point to them in coming up with an instant explanation as to why a certain extremist group did this or that. Or, why extremist groups may be expanding in certain areas after months of silence. Still, while a direct one-to-one relationship between the deteriorating socio-economic factors and extremist recruitment is hard to make, there can be no doubt strong links exist.

⁵ Alan Richards, "At War With Utopian Fanatics," Middle East Policy 8:4 (December 2001), pp 5-9.

⁶ Richards, op. cit.

⁷ "Islamic Extremists: How Do they Mobilize Support?" Special Report 89 (Washington: United States Institute of Peace, July 2002).

⁸ See for example, Jennifer Bremer and John Kasarda, "The Origins of Terror," The Milken Review (Fourth Quarter 2002), Robert Looney, "Failed Economic Take-Offs and Terrorism in Pakistan," Asian Survey XLIV:6 (November/December 2004).

A diagnosis of the country's economic situation suggests a redirection of its economic policies are needed to produce the type of broad-based sustained growth necessary to combat the destructive pull of extremist groups in that country. The interrelationship between the socio-economic environment and extremism in Iraq is complex, but critical to understanding its dynamics is critical in designing a fresh approach towards economic development in Iraq.

The Post-War Development Strategy

A major problem in designing an economic strategy for Iraq is that the country's economic environment does not fit nicely into a category handled by one of the standard development strategies. In fact, the immediate post-war Iraqi economy could conceivably be viewed from a number of perspectives, each encompassing certain aspects present today. In this sense Iraq resembles a:

1. Transition economy, similar to those countries in Central and Eastern Europe as well as the former Soviet Union. Here the main goals of policy would be the establishment of a free market system and the institutions needed to support the efficient operation of markets – the creation of a Central Bank, efficient tax system, as well as a seamless integration into world markets. Privatization would play a key role as well as the adoption of sound macroeconomic policies.
2. Failed State, where the government no longer has the ability to provide basic services, maintain law and order, make collective decisions. Large segments of the population have drifted into the informal and criminal markets as a result of rapid demographic growth and a stagnant economy⁹. Particularly important are the restoration of an open trading system, resolution of group grievances and the halting of economic decline.
3. Rentier Economy, where the economy is overly dependent on the oil sector for foreign exchange and government revenues. Here, economic programs should encourage diversification, the development of the agricultural sector and other areas where the country had a potential comparative advantage. Because the governments of rentier states often are not dependent on the population at large for revenues, they tend to evolve into authoritarian regimes, capable of buying off or suppressing opposition. One way to counter these tendencies is to establish an oil fund to be distributed to the population at large. The transfer of a large percentage of oil revenues to the population not only reduces the chance of anti-democratic regimes, but also builds up mass purchasing power capable of providing large mass markets for a growing private sector.
4. Post-Conflict Economy in which the restoration of physical and social capital and supporting institutions is often the main focus, with neoliberal reforms postponed until a basic level of stability can be restored. Community

⁹ Other characteristics can be found in Foreign Policy and the Fund for Peace, "The Failed States Index," Foreign Policy 149 (July/August 2005), pp.56-64.

development is often the foundation for restoring stability and meeting the short-run needs of the population at large.

5. Failed-Take-off Economy in which past successes have raised expectations only to be unrealized due to institutional rigidities. Past inability to sustain growth however often results in widespread cynicism concerning government policies – a environment often exploited by extremist groups.¹⁰ Here the introduction of increased economic freedom and on-going reforms to create a choice based economic system often enables growth to be sustained.

Clearly Iraq possesses elements of each of these economic environments. However, given the strong pro market orientation of the Bush administration and is aversion at the time to nation building the transition view, especially its shock-Therapy variant has dominated U.S. economic policy in Iraq.¹¹ A good case can be made that this approach was sound. The region as a whole has been slow to globalize and embrace free markets along the lines suggested by the so-called Washington Consensus. Those advocating a neoliberal or Washington Consensus view stress that only through a private sector led export oriented economic development strategy will the major countries in the region have a chance of coping with the development challenges facing the region.¹²

Perhaps based on the experience in Chile in the 1970s planners in Washington assumed that with economic growth quickly restored through the exploitation of opportunities in free markets a virtuous circle could be established whereby the early winners in the new Iraq would press for further political and institutional reforms – thus creating more economic growth and a growing group of entrepreneurs with a high stake in pressing for broader and deeper reforms.

A major advantage of shock therapy is that it rapidly reduces the power of entrenched groups from the prior regime. Another reason to opt for this approach is that economic reforms are much easier to introduce than changes in basic governance structures. As Richards notes, “A strong case can be made that Middle Eastern economics have failed thanks to institutional—and political deficiencies. Outsiders can do very little to promote institutional change, as the US has learned in Russia and elsewhere.”¹³

To this end, in 2003 with Iraq’s economy still shattered following the ouster of Saddam Hussein, the Coalition Provisional Authority (CPA) initiated a package of neoliberal, free market reforms, discredited in Latin America and reminiscent of the “Shock Therapy” programs carried out in the early- to mid- 1990s in many of the

¹⁰ Jennifer Bremer and John D. Kasarda, “The Origins of Terror: Implications for U.S. Foreign Policy,” *The Milken Institute Review* (Fourth Quarter 2002).

¹¹ Cf. Robert Looney, “The Viability of Economic Shock therapy in Iraq,” *Challenge* 47:5 (September-October 2004), pp. 86-103.

¹² Alan Richards, “Socio-Economic Roots of Radicalism? Towards Explaining the Appeal of Islamic Radicals,” *Strategic Studies Institute* (July 2003).

¹³ Alan Richards, “Socio-Economic Roots of Radicalism? Towards Explaining the Appeal of Islamic Radicals,” *Strategic Studies Institute* (July 2003).

transition economies of Central and Eastern Europe. Overnight, Iraq became the most open economy in the Arab world.

Unfortunately, to date the postwar socio-economic environment along with the insurgency has worked to deter private investment and economic recovery. For every bright spot of renewed activity, there are several key areas showing retrogression or scant improvement. While the insurgency receives most of the blame for the economy's slow recovery, it's a chicken and egg situation with post-War economic policy a major contributing factor.

Diagnosis

1. In retrospect, given the post-War state of affairs in Iraq, adoption of a neoliberal/Washington Consensus free market development strategy was a mistake.¹⁴ While an ideal policy mix in certain situations, as applied in Iraq it has gone down a number of dead-ends as a result of serious miscalculations and faulty assumptions.
2. By its nature this strategy largely precludes large segments of the population from the decision making process – only those with the pre-requisites – the proper education, appropriate skills, financial capital to draw on etc. can immediately thrive. Few of these skills or assets exist in today's Iraq.
3. Its main strength is in providing incentives to private investors, but in a conflict country like Iraq this is not enough to offset the high level of uncertainty. As Stephen Glain as observed "In the relatively peaceful months that followed Saddam's removal, it seemed Iraq would no longer need Jordan as an enclave. Two years later, the colony of affluent Iraqis in Amman is a measure of how estranged war-town Iraq has become from its private sector."¹⁵ Even in Chile, its main success story, several years of difficult restructuring under a very stable government occurred before investors felt confident in taking a stake in the country's future.
4. While many have argued that a trade oriented development strategy might provide added incentives for the private sector, shifting international markets and trade relationships might create added instability through sudden drops in the output from industries with limited domestic markets. Also, it appears that reforms in the trade area for countries at Iraq's stage of development are not particularly effective in inducing follow on reforms in key areas of governance.¹⁶

¹⁴ For a detailed description and assessment of the neoliberal reform package in Iraq see: Robert Looney, "The Neoliberal Model's Planned Role in Iraq's Economic Transformation," *Middle East Journal* (Autumn, 2003); Robert Looney, "The Viability of Economic Shock Therapy in Iraq," *Challenge*, 47:5 (September-October 2004), and Robert Looney, "Postwar Iraq's Financial System," *Middle East Policy*, XII:1 (Spring 2005).

¹⁵ Stephen Glain, "Land of Tycoons: Many Iraqi Businessmen are Running their Emires form Self Exile in Jordan," *Newsweek* (International Edition) June 27, 2005, p. 46.

¹⁶ Robert Looney, "U.S. Middle East Economic Policy: Are Trade Based Initiatives an Effective Tool in the War on Terrorism," *Strategic Insights* IV:1 (January 2005).

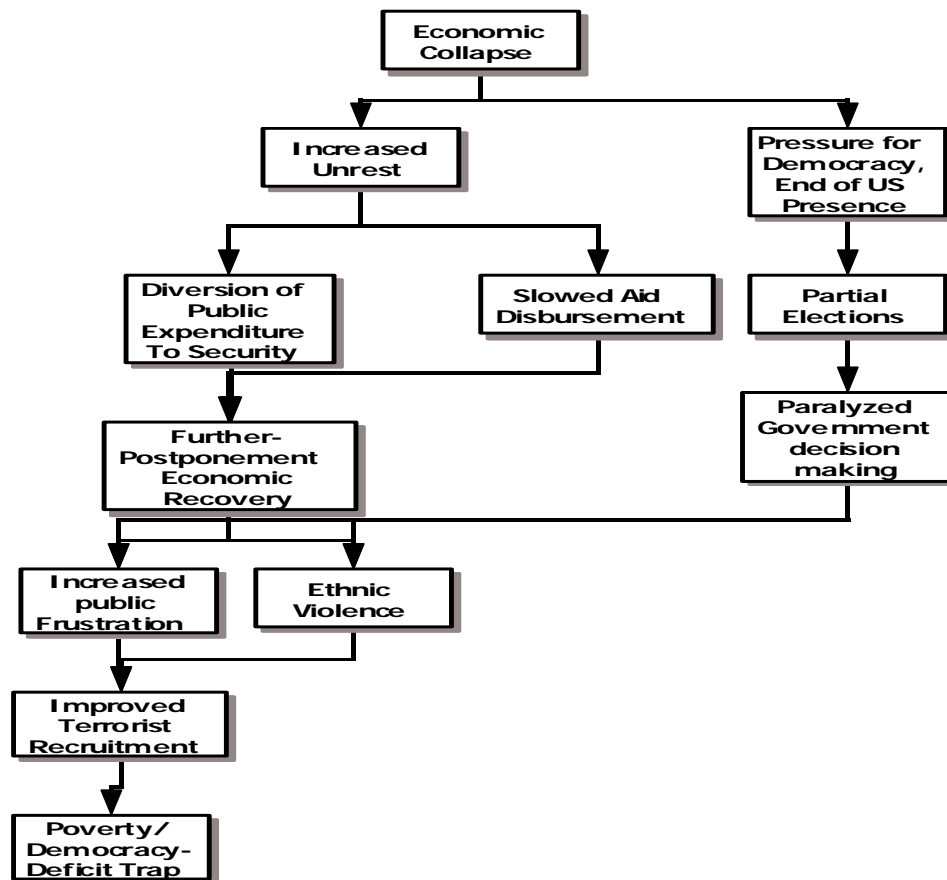
5. The neoliberal approach is not evolutionary – when things begin to go wrong, there is not an automatic adaptive policy. In mature economies this adaptation is usually through price movements, but in a country coming out of war, sanctions and a long history of socialism, a period of institution creation and strengthening is necessary before markets can be expected to perform this function.
6. As in other parts of the world, the neoliberal program is an easy target for radical groups. While in abstract terms, it makes a great deal of sense, its stress on openness to trade and foreign investment make it an easy target for arguments contending that the program is just another form of imperialism – a program largely designed for exploitation of weaker countries and groups. The extreme form of neoliberalism introduced in Iraq lends considerable credibility to these claims as does the initial stress on privatization.
7. The neoliberal philosophy also discourages large scale government intervention in the economy. This, together with market instability, creates high levels of uncertainty and the impression that the government is powerless to respond to crisis or adversity. As a result, unemployment has stabilized in the 30-40% range with large segments of the Iraqi population having a sense of hopelessness concerning their futures.
8. The insurgency aside, it is problematical whether the neoliberal reforms would have jumpstarted the economy. A large shadow economy exists, perhaps accounting for 65% of Gross National Product and 80% of the labor force. This market is largely outside the normal forces of supply and demand, requiring specific and directed policies to assure its transition into the regular economy.
9. Transition economies with large shadow economies, but much more favorable initial conditions experienced sharp contractions for up to five years after introducing even milder reforms. Even under normal circumstances, this would have been the likely scenario for Iraq.
10. While one intent of the reforms was to dismantle as quickly as possible institutions linked to the previous reform, the neoliberal policies were not, as expected, capable of initiating a process of new institutional development. The resulting vacuum was largely filled by already organized groups: religious, criminal and radical elements.
11. Because the neoliberal reforms were only partially introduced, with a number of controls still in effect, significant and sizeable black markets have developed -- the most important in petroleum products. The resulting scarcity of fuels has had a debilitating effect on several important sectors of the economy. It has also lent credibility to extremist claims that the Coalition is only there to appropriate Iraqi oil.
12. In effect the economic system to date has been much more efficient at creating an environment for criminals and extremist elements to thrive than it has for

private investors. Much of the funding for extremist groups comes from black market arbitrage, further enabling their recruitment efforts.

The danger is that the current economic malaise will deteriorate to the point where the economy will stabilize in a poverty debt trap (Figure 1).

Figure 1

Iraq: Low level Poverty/Debt Trap



In short, the performance of the economy and the pain caused by the neoliberal reforms extremist groups has no doubt contributed to their recruitment efforts in Iraq. After decades of socialism, Iraqis were not ready, nor were they properly prepared, for the uncertainties created by a new system. Many Iraqis perceived the system as imposed without their consent. The added uncertainty created by threats of mass privatizations, high unemployment rates, shortages in key areas, and the seeming inability of the government to respond was exploited to the fullest extent by the extremists.

Implications for Extremism

Still, at this point it is idle to speculate whether the deteriorating economic situation is responsible for the increased recruitment by extremist groups or is caused

by the increasing terrorist acts performed by these groups. No doubt the deteriorating economic situation and rise in the insurgency are interrelated in complex ways. A good guess is that the inability of the early economic programs introduced into Iraq to address short-run economic needs created an environment easily exploited by extremist groups.

Specifying direct links between the deteriorating economic situation and extremist recruitment in Iraq is also difficult simply because a multitude of factors are at work – some more important for certain individuals, other factors more important for different groups. The development of large numbers of extremist recruits requires at least three elements (1) lack of state capacity, particularly in the areas of police, intelligence, and law enforcement; (2) a “mobilizing belief,” such as Salafist/jihadist extremism; and (3) appropriate agitators who can propagate these ideas and create an effective terrorist force.¹⁷ Clearly (1) and (3) are present in Iraq with (2) a latent factor and the focus of many of the Jihadis infiltrating into the country.

The situation in Iraq is complicated by factors such as ethnic conflicts, a large criminal element hold-over from the period of sanctions, pervasive corruption and whole spectrum of other contributing factors, some of which are summarized in Figure 2. What is fairly certain is that the longer the economy remains incapable of providing viable work for large segments, and is seen as incapable of doing so in the future, the more attractive extremism will become.

Is the situation hopeless? Middle East expert Ken Pollack feels that the deteriorating security situation in Iraq stems from the fact that an effective counterinsurgency policy is not in place. “We lost in Vietnam for a complicated set of reasons. But the most important was that we refused to use an effective counterinsurgency strategy. We focused more on hunting down Vietcong guerrillas than on protecting the Vietnam people, which in turn prevented the South Vietnamese economy from growing and giving the people an incentive to support our side of the war.”¹⁸

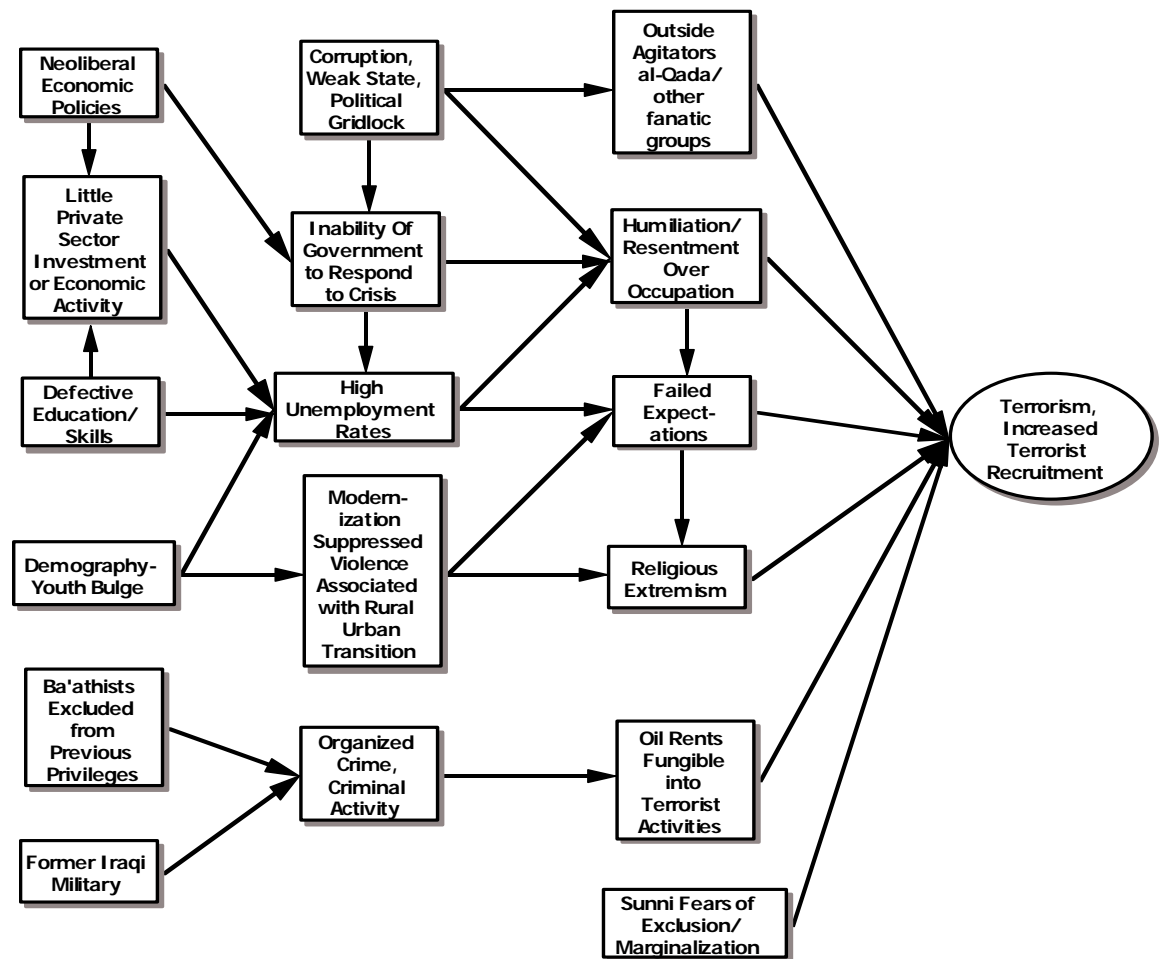
Pollack finds putting the population first through improving safety is the key to counterinsurgency efforts in Iraq. A people first approach is also critical to restart the economy. “Reconstruction is most likely to succeed if it can grow from the bottom up. Certainly the top-down approach we are now employing has rarely worked in the past...We need to push resources out from Baghdad or circumvent it shipping supplies directly into the hands of the Iraqis who can help at the local level.” Just as in Pollack’s case where hunting down the Vietcong guerrillas was a necessary but not sufficient condition for success, so too are the neoliberal reforms a necessary, but not sufficient set of policies for economic recovery and growth.

¹⁷ William Rosenau, “Al Qaida Recruitment Trends in Kenya and Tanzania,” *Studies in Conflict and Terrorism* 28 (2005), pp. 1-10.

¹⁸ Kenneth Pollack, “Five Ways to Win Back Iraq,” *New York Times*, July 1, 2005.

For its part the Iraqi government hopes to put the country on a new course as outlined in its National Development Strategy (NDS).¹⁹ Simply put, the Iraqi Government's vision is to "transform Iraq into a peaceful, unified federal democracy and a prosperous, market oriented regional economic powerhouse that is fully integrated into the global economy. While few would fault these objectives, in reality the NDS represents only cosmetic changes in the original set of neoliberal reforms.

Figure 2
Iraq: Factors Contributing to Extremist Recruitment



Unfortunately the NDS is another top – down approach, based on the same faulty assumptions underlying the neoliberal/Washington Consensus programs. Perhaps even worse, expectations for a better life were raised with

¹⁹ Iraq's Strategic Vision for National Development: Presented to the International Conference on Iraq, Brussels, Belgium 21-22 June 2005 (Baghdad: Ministry of Planning and Development Cooperation, 2005).

the overthrow of Saddam Hussein. The continuation of a failed strategy most Iraqis have little influence over for change has in other contexts created an environment ripe for extremists.²⁰

Also surprising, despite the presence of all a whole spectrum of socio-economic factors contributing to extremism, is the absence of any mention in the NDS of this phenomena. Neither in terms of its threat to the country's future or the manner in which the Plan hopes to counter it. As the US counterinsurgency efforts have largely overlooked the potential contribution that could be made through proper aid based socio-economic policies, it appears the country's socio-economic planners have followed suit.

As in the case of Ken Pollack's question concerning the security situation in Iraq -- Is the situation hopeless? In the economic area a one arrives at a similar answer. An effective economic strategy is not in place. Other than a few merchants, no real constituency with a stake in the system is being created. For the large segments of the population untouched by pockets of economic improvement, resentment and frustration create an ideal environment for extremist recruitment.

As noted above, the counter argument that if it wasn't for the insurgency's economic sabotage the economy would be doing much better has merit. The fact however is that by its nature the neoliberal system is optimal at promoting long term growth, not in providing a short-term stimulus with significant job creation. Even under optimal conditions, it was unreasonable to expect the surge in investment to begin immediately after the reforms were introduced. In many of the Eastern and Central European countries it took four or five years under much more favorable conditions for the private sector to begin to undertake significant levels of investment. Even for the medium term, the situation as demonstrated by the experience of Latin America noted above, a surge in investment and job creation was also problematical.

Components of a Comprehensive Development Strategy for Iraq

As things stand in Iraq, many Coalition programs are not having much of an impact at the household level. The neoliberal reforms noted above are a top-town approach towards the economy, with often little trickling down. On the other hand many infrastructure projects carried out are not necessarily the ones the Iraqis themselves would have opted for given a significant input into the decision making process. While employment is created by these projects none are really the part of an overriding development strategy geared to meeting specific objectives that the Iraqis themselves would have necessarily opted for.

²⁰ Cf. Robert Looney, "Failed Economic Take-Offs and Terrorism in Pakistan," Asian Survey, XLIV:6 (November/December 2004), pp.771-793.

In other words, there is a large disconnect with what goes on at the macro levels and at the project level. Part of this stems from the fact that the country has no real development strategy – documents abound, but none of these approaches the country's economic recovery and growth in a systematic, integrated manner. As result and because the Iraqis have had very little significant input into the process it is not clear that existing or proposed programs are efficient in any meaningful way in meeting the average citizen's needs. For this reason many Iraqis feel alienated with little stake in the current system. The indirect stimulus from the neoliberal reforms is not impacting on their lives and the direct impact stemming from individual reconstruction projects is not sufficient to make significant impacts on their standards of living.

Fortunately the historical record supplies some general principles to bear in mind in designing a fresh development strategy for Iraq.²¹

1. In practice, growth spurts are associated with a narrow range of policy reforms. One of the most encouraging aspects of the comparative evidence on economic growth is that it often takes very little to get growth started. In fact, relatively small changes in the background environment can yield significant increases in economic activity. This is good news for Iraq because it suggests that the country need not introduce an extensive set of institutional reforms to start growing. This reflects the fact that given the country is far below its potential level of income even moderate movements in the right direction can produce a big growth payoff.
2. The policy reforms that are associated with these growth transitions typically combine elements of orthodoxy with unorthodox institutional practices. No country has experienced rapid growth without minimal adherence to the higher-order principles of sound economic governance—property rights, market-oriented incentives, sound money and fiscal solvency. However, as the Iraqi record shows these policies are usually not sufficient by themselves to set off a cumulative growth process. In nearly all successful instances of growth this basic policy environment was combined with public intervention and selectivity of some sort. In nearly all cases this intervention was unorthodox and designed to take into account certain unique aspects of the local environment.
3. Institutional innovations do not travel well. The more discouraging aspects of development strategies is that the policy packages associated with growth accelerations—and particularly the elements therein that are non-standard—tend to vary considerably from country to country. Attempts to emulate successful policies elsewhere often fail.
4. Sustaining growth is more difficult than igniting it, and requires more extensive institutional reform. The historical record shows that the majority of growth spurts tend to run out of gas after a while. Hence growth in the short-to medium term does not guarantee success in the long-term. He experience of

²¹ Dani Rodrik, "Growth Strategies," John F. Kennedy School of Government (August 2004), pp.

Latin America since the early 1980s and the even more dramatic collapse of Sub-Saharan Africa are emblematic of this phenomenon. A plausible interpretation is that the initial reforms need to be deepened over time with efforts aimed at strengthening the institutional underpinning of market economies.

With these general guidelines in mind, it is possible to sketch out a economic development strategy in a manner consistent with reducing the pull of extremists. Briefly, three aspects of the reform program are critical. First the strategy will have to incorporate the main problems associated with each of the five views of the economy noted above. Failure to do so will leave gaps in the strategy likely to undermine positive developments in other areas – unaddressed structural conditions will increase the likelihood of growth being unsustainable.

Second, is there a credible approach that addresses the main deficiencies of neoliberalism? While the conventional wisdom at the beginning of the 1990s was that no credible alternative existed, that is no longer the case. Much of the current thinking on the factors needed for a successful development strategy come out of the experience of the Transition countries in the 1990s. The experience of transition shows that the neoliberal policies of liberalization, stabilization and privatization that are not grounded in adequate institutions may not deliver successful outcomes. As Professor Roland notes:

Thus there has been a shift in emphasis from markets and price theory to contracting and to the legal, social and political environment of contracting. Transition has not only helped to reinforce this change of focus in economic thinking, it has also renewed interest in thinking about the interplay and complementarities between the various constitutive institutions of capitalism. Finally, transition has forced us to think about institutions not in a static way, but in a dynamic way: how momentum for reform is created, how institutions can evolve but also how momentum can be lost, and how one can get stuck in inefficient institutions. In this sense, transition has reinforced what I would call the evolutionary-institutionalist perspective, insisting both on the environment of agents at any moment in time but also in its evolutions.

²²

In Iraq's case, the most important differences between the two paradigms are no doubt related to their flexibility in adapting to unanticipated developments. For the Neoliberal approach, the political economy emphasis is, as was the case, in Iraq in 2003 to use early windows of opportunity of periods of "exceptional politics" to push reforms through as fast as possible and to create irreversibility.²³

²² Gerard Roland, "Ten Years After...Transition Economics," IMF Staff Papers 48 (2001), pp. 29-52.

²³ Gerard Roland, "Ten Years After...Transition Economics," IMF Staff Papers 48 (2001), pp. 29-52.

The new institutionalists view this strategy as dangerous locking countries into inefficient economic structures that are hard to reverse because of the irreversibilities created. The emphasis is rather on ensuring a continuous and growing support for reforms among the population. This implies a more gradual and experimental approach to reforms, relying on the flexibility of experimentation with an adequate sequencing of reforms to possibly reverse reforms that do not work and try other ones.²⁴

Certainly a shift from the neoliberal paradigm to the new institutionalist model of development is called for in Iraq. However, given the large number of degrees of freedom, it makes the most sense at this point in time to simply sketch out a broad approach to reform. The presumption is that within this framework there is ample scope for modification, and while some measures might improve the likelihood of a liberal market economy eventually thriving in the country, implementing the complete set of actions is not critical in this regard. Instead, given the security situation and desire to combat the pull of extremists it is better to focus on a few high impact policies.

Third and building upon the new institutionalist model, Iraq's strategy will have to be one that is capable of creating a virtuous circle, with progress in one area creating incentives/pressure for progress in other areas. In short, economic programs, projects and reforms will have to be designed capable of creating sufficient momentum to overcome the physical, economic, demographic, networking and political impediments to growth. Here, corruption and the stake many have in maintaining the current system are particular obstacles. As long as the current set of reforms remain stalled, the more entrenched those opposing reforms will become.

Fourth, the various elements of the development strategy must interact as a coherent whole with each element reinforcing the others. Several key supporting elements stand out: (1) an oil fund distributed to the population at large, (2) a dual-track strategy that focuses on both the development of the formal and informal segments of the economy, (3) the reorientation of reconstruction towards community development and (4) a reorganization of aid delivery mechanisms and an expansion to assist the funding of (2 and (4).

Fifth, implementation will require the expansion of several existing programs:²⁵

The Local Governance Project (LGP)

The LGP program represents an ambitious attempt at establishing democratic governance in Iraq. Specifically, the program's goal is the establishment of local institutions that are representative, responsive and capable of addressing citizens' needs and desires. To this end, the creation of

²⁴ Gerard Roland, "Ten Years After... Transition Economics," IMF Staff Papers 48 (2001), pp. 29-52.

²⁵ Thanks to LtCol John P Boland (CE G5 G&E Econ Officer) for providing valuable insights and the basic documents pertaining to the current situation in Iraq.

social capital — the creation of links across different social, religious and ethnic groups is also a major objective of this program.

Commander's Emergency Response Program (CERP)

The purpose of the Commander's Emergency Response Program (CERP) is to provide commanders with a means to respond to urgent humanitarian relief and reconstruction assistance that can be implemented quickly and have an immediate impact on the Iraqi people.²⁶ This is a creative and important program designed to provide U.S. governmental appropriations directly to tactical units for the purpose of meeting emergency needs of local Iraqi civilians (a similar program exists in Afghanistan).

With most projects averaging \$50,000 CERP provides a quick and effective method that provides immediate, positive impact on the Iraqi people, while other larger reconstruction projects are still getting off the ground. The key to project selection is: (1) execute quickly; (2) employ many Iraqis; (3) benefit the Iraqi people and (4) may be highly visible.²⁷

Office of Transition Initiatives (OTI)

OTI's strategic objective, "political transition successfully advanced in priority, conflict-prone countries," is the basis for the short-term, flexible and rapid assistance it provides in transitional settings. OTI's support during transitions to peace and democracy and transitional political crisis has the potential to help create a strong foundation for longer-term targeted development programs. This program has been greatly under-funded, yet has the potential to play a critical role in Iraq, especially if it is closely coordinated with the in conjunction with LGP programs and the CERP.

Summarizing the proposed strategy:

1. Shifting from a neoliberal/Washington Consensus development strategy to one along neo-institutionalist lines as done in several of the Transition countries would reorient the development process in a manner encompassing more groups into the country's decision making and development process.
2. In contrast the neoliberal approach of relying on a whole spectrum of reforms, the neoliberal approach would shift attention to certain key areas critical to the building up of a momentum for further reforms.
3. Instead of the neoliberal stress on liberalization, stabilization and privatization, the evolutionary approach focuses on creating the institutional underpinnings of markets needed to insure strong entrepreneurial development.

²⁶ CERP Family of Funds: Fiscal Policies, Processes, and Standard Operating Procedures (Baghdad: Multinational Corps-Iraq, June 29, 2005), p. 2.

²⁷ CERP Family of Funds: Fiscal Policies, Processes, and Standard Operating Procedures (Baghdad: Multinational Corps-Iraq, June 29, 2005), p. 4.

4. While the neoliberal approach has focused on creating a clean slate by breaking up existing state structure, the institutional approach would attempt to use existing institutions to prevent further economic disruption and social unrest while developing new institutions.
5. A community development based development strategy fits into this general framework enabling Iraqis to participate in designing programs and policies in tune with their direct needs. The result would be better project selection, completion, and satisfaction, lessening the pull of extremist groups.²⁸
6. The community based strategy should be focused not just on deriving local development plans to be funded through redirected aid allocations. A key element of this strategy is to gradually repair the social capital linkages destroyed by the previous regime. Starting at the local level and expanding to the region and eventually the national level, networks would strengthen not only the workings of the economic system, but also assist in the creation of a viable Iraqi state.
7. In shifting towards a community development based strategy, programs at the local level should build on three highly successful programs, but to date vastly under-funded: (a) the Commanders Emergency Response Program (CERP), (b) the Local Governance Project (LGP) and Office of Transition Initiatives (OTI).
8. These three programs have largely operated independently, but should be closely coordinated and their orientation (mainly CERP) expanded to allow the funding of private sector projects. There is some evidence that there has been an over expansion in certain areas – schools, and other public sector activities. At this time the biggest impact per dollar will come from assisting the establishment of private, labor-intensive start up companies.
9. Distributing a certain percentage of oil revenues to the Iraqi public through the creation of an oil fund, would provide added demand for a wide range of domestic consumer goods. Part of this payment to Iraqis could be made conditional on participation in local clean-up programs while short-term training programs were providing the skills needed by private companies.
10. A Development Bank should be established, and funded by an additional share of oil revenues. This would be a temporary to allow time for the commercial banking system to gain the expertise to eventually perform this function. The bank would specialize in small loans to start-up companies, encouraging the participation of women in the economy.
11. A goal of the newly created Development Bank would be regional balance with lending oriented toward a fairly even distribution of new firms across the country.

²⁸ The rationale for a community development oriented approach has been developed by Jason Ben-Meier. See his "Create a New Era of Islamic-Western Relations by Supporting Community Development," Strategic Insights III:4 (April 2004).

12. Within this context, the shift to a dual track development strategy with a focus on supporting small-and medium-sized enterprises (SMEs) would draw many entrepreneurs out of the informal sector, further assisting in the creation of new firms and associated employment.
13. Two areas of governance are critical for the private sector to take hold and thrive in Iraq: secure property rights and an improved rule of law. In the past deterioration in the rule of law and related institutional enforcement mechanisms has shifted the balance of incentives toward participation in the informal economy.
14. Improved macroeconomic stability will be critical in providing the right price incentives for private sector investment and activity. With growth inflationary pressures, the government will need to develop an improved stabilization tools, perhaps starting with an oil stabilization fund to better smooth out expenditures, avoiding short run bursts of disruptive austerity measures.
15. In Iraq's case, large allocations of assistance should be directed to two key areas noted above – small scale enterprise development and community development. Particularly in the case of community development the use of grants should be seriously considered. As the Meltzer commission observed, this provides a more effective means of monitoring projects and providing incentives to recipients.
16. Progress, as judged by annual independent audit, of stipulated outputs. This and other safe-guards might also help assure that community programs would not be taken over or reoriented by extremist groups.
17. Once the process is underway, several links between added employment and further demand creation would reinforce in a virtuous cycle-type mechanism the employment creation capability of the economy.
18. Most importantly, with the creation and expansion of a new class of entrepreneurs and those with a stake in seeing the reform process move ahead.
19. Further reforms, the reduction of corruption and the creation of and expansion of extended networks would build up the momentum to hopefully assure the viability and continuance of a liberal market economy.

Taken as a whole these policy initiatives have the potential of not only significantly expanding domestic employment opportunities, but perhaps more importantly doing so through the creation of a virtuous cycle with feedbacks between the domestic market, further reforms and the labor markets (Figure 3).

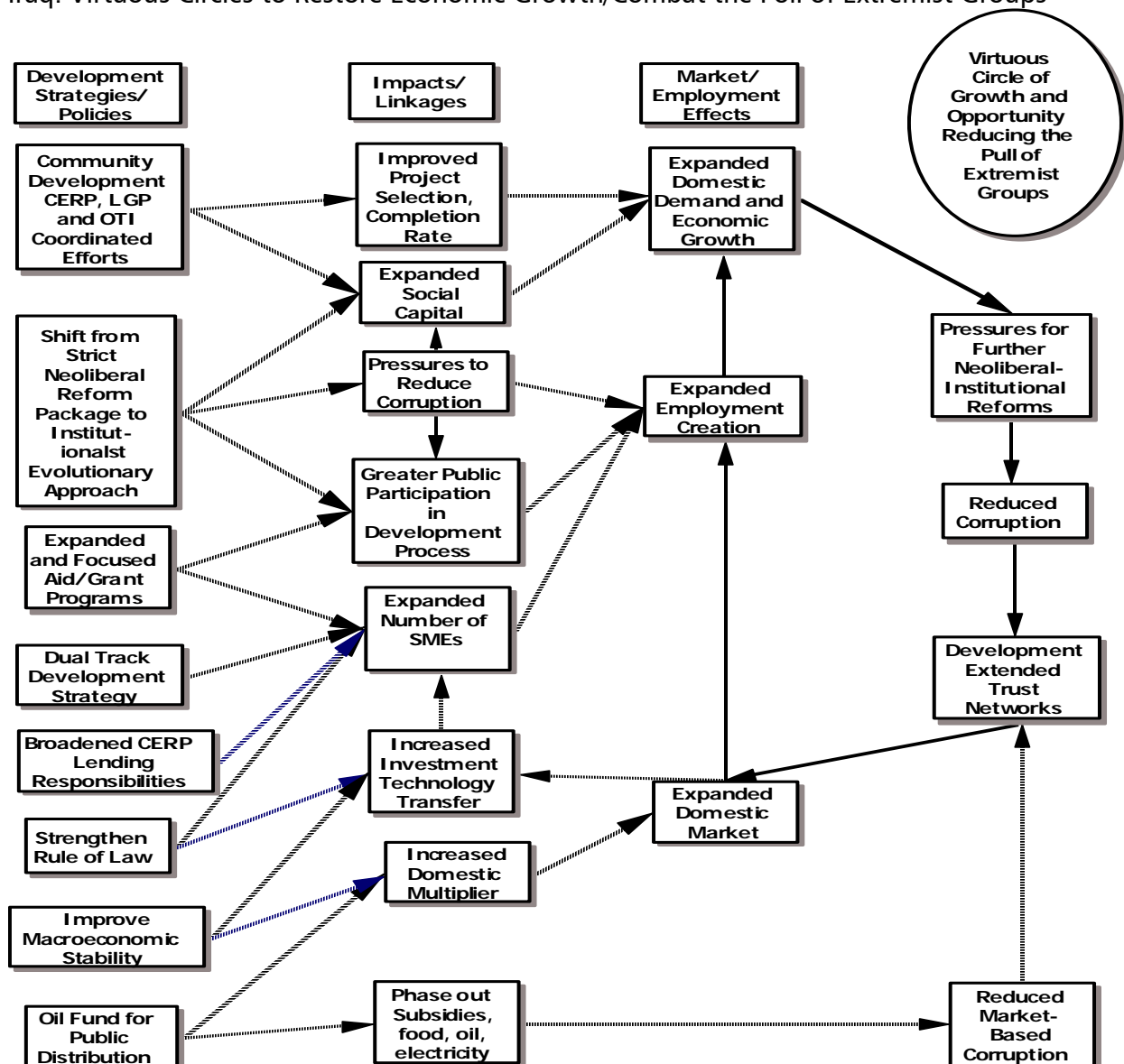
Community development programs should be started and greatly expanded in those areas security permitting. Local participation, project identification and implementation are the most rapid way to attack the current unemployment problems

while reducing the insurgency threat. Iraqis must feel they have a real stake in the future and that it is within their control.

In terms of timing, the first priority should be to expand and build on existing, successful programs. While a number of these programs exist, the CERP program stands out and should have a significant increase in its funding. There is a growing consensus that if this program had had more funding all along we would not be in the mess we are now. The program should be modified slightly to assure its support of overall community development programs. In addition, expanding CERP's scope to include the funding of private sector ventures would probably be the quickest way to obtain an immediate impact on Iraqi jobs and incomes. The capability exists in CERP for this broadened responsibility.

Figure 3

Iraq: Virtuous Circles to Restore Economic Growth/Combat the Pull of Extremist Groups



Second, the other two programs mentioned above, LGP and OTI, should also be greatly expanded and their efforts coordinated with the CERP. There has been a natural tendency for LGP and OTI programs to be absent from areas where security is an issue. Teaming them up with CERP is one way of extending their presence to areas of potentially high impact. The close coordination of these two programs with CERP could provide the needed security for the continuity needed to develop and implement quick action programs meeting the needs of the average Iraqi. However, the joining of forces of CERP, LGP, and OTI is not a natural one and will require some creativity in focusing the strengths of each on a common course of action – results will easily justify the effort.

Third, work is underway concerning the rule of law and property rights. This should be given a higher priority and additional resources for speedy resolution. The remainder of the programs noted above – Development Bank, Oil Fund, Dual Development/Informal economy credit programs can be gradually phased in as funding and personnel permit. They are needed programs to sustain the momentum built up by expanded CERP, LGP and OTI efforts.

Assessment

As noted a whole spectrum of factors affect terrorist recruitment. Interviews with members of Hamas and Islamic Jihad, suggest these groups actively recruit to fill potential leadership positions while relying more heavily on volunteers to carryout martyrdom attacks and general foot soldier functions.²⁹ There is little to suggest the situation is fundamentally different for extremist groups operating in Iraq.

Thus for large numbers of Iraqis a poor economic environment and lack of other profitable economic activity can be a major factor in their decision to join a extremist organization. The other options are service in the Iraqi Police/military or criminal activity. For many Sunnis the options are only criminal activity or an extremist group. Former Ba'athists and Iraqi military often find their options are even narrower in today's Iraq.

The job-oriented community development strategy has the potential to marginalize extremists by strengthening indigenous democratic processes that generate economic prosperity.

Community empowerment occurs through a gradual, nonviolent, and generally accepted process because of the collective and individual benefits the community experience. As people achieve their own interests, they feel less alienation; their zone of tolerance expands, because the underlying conditions that fuel extremism are being addressed. Those affected then are less likely to channel hatred toward

²⁹ Nasra Hassan, "An Arsenal of Believers: Talking to the Human Bombs," The New Yorker (November 19, 2001).

outside actors or allow themselves to be used as tools of destruction. Additionally in the Muslim world, as the majority of people in communities, regions, and nations come to enjoy the benefits of the local development approach, the more they will be emboldened to fight extremism within their own countries.³⁰

For a smaller group of Iraqis, community development and increased prosperity may not be a sufficient step. Disaffected youth are the main recruits into terrorist organizations. Experts cite a series of factors, ranging from social deprivation, to cultural disenchantment and a sense of deep injustice harbored by many Muslims.

People turn to fundamentalist ideology (and perhaps at some stage to violence), says Oliver Roy, a French researcher on Islamist movements, because it “appeals to an uprooted, disaffected youth in search of an identity beyond the lost cultures of their parents and beyond the thwarted expectations of a better life.”³¹

Roy’s observations may have been quite true before the overthrow of Saddam Hussein. Since that time, however the occupation of Iraq and the dire state of affairs there have produced a new pool of potential recruits for extremist groups. Within Iraq, former Ba’thists, ex-Military officers, and Sunnis feeling excluded from the country’s future, and others resenting the U.S. presence will somehow have to be integrated back into Iraqi society and political system.

Outside of Iraq, Jihadist leaders who in the past pointed to Palestine or to the United States’ enforcement of the U.S. embargo of Iraq and America’s “cultural aggression” against Muslim lands never generated that many recruits. The invasion of Iraq has incensed even many moderate Muslims to take action.³²

To further stem the “Iraq effect” on extremist recruitment in Iraq and other countries, the U.S. will not only have to eventually withdraw from that country, but it must withdraw leaving the start of democratic institutions and a viable, dynamic economy capable of including and benefiting broad segments of the population. While hard core religious fanatics will be largely unaffected by these actions, success in Iraq may represent the most effective long-run strategy to stem the pull of extremist groups in Iraq and throughout the Middle East. This is not necessarily an impossible task, but it is one that will require much more thought, acceptance of prior mistakes, planning, and encouragement of Iraqi input than has occurred in the past.

³⁰ Jason Ben-Meir, “Creating a New Era of Islamic-Western Relations by Supporting Community Development,” *Mediterranean Quarterly*, 15:3 (Summer 2004), p.46.

³¹ Roula Khalaf, “Disaffected Youths Find Identity in fundamentalist Ideology,” *Financial Times* (July 13, 2005).

³² “Net Assessment: the Jihadism Movement,” *Stratfor* (November 26, 2004).